

## CREDIT OPINION

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# Arlington (City of) TX

## Update following upgrade of special tax bonds

### Summary

The [City of Arlington's](#) (Aa1 stable issuer rating) senior lien special tax revenue bonds (Aa3 stable) benefit from the resiliency of the city's sales tax revenues, even through economic cycles, which are underpinned by a dynamic economic base. Partially offsetting the strong historic trend is the moderate economic concentration in the city in professional sports and large entertainment. The senior lien exhibits strong debt service coverage and is bolstered by the strength of the legal framework, including a common senior lien debt service reserve fund (DSRF) funded at maximum annual debt service (MADS), a closed lien, and closed loop of funds. The subordinate lien (A1 stable) rating reflects a weaker credit profile given its second priority lien on pledged revenues. However, the subordinate lien similarly benefits from elements common to both liens, including the economic base that has supported strong revenue growth over the past two years, subordinate lien reserve fund funded at MADS, the closed lien, and the closed loop of funds. Further, early retirement of callable subordinate lien bonds has led to improved MADS coverage.

On May 25, we upgraded the rating on the senior lien special tax bonds to Aa3 from A1 and the rating on the subordinate lien bonds to A1 from A3.

### Credit strengths

- » Strong legal structure including broad pledged revenues, closed lien, closed loop of funds, and separate DSRF per lien
- » Historically solid pledged revenue trend with only minimal decline during economic downturns
- » Improved MADS coverage on both liens due to growing revenue and early principal retirement of subordinate lien bonds

### Credit challenges

- » Economically sensitive pledged revenues and no ability to increase tax rates for various pledged revenue sources
- » Narrow but improving subordinate line debt service coverage

### Rating outlook

The stable outlook reflects the expectation that pledged revenue will not decline, leading to maintenance of healthy coverage for both liens.

## Factors that could lead to an upgrade

- » Growth in pledged revenue or early debt retirement that drives significantly improved debt service coverage

## Factors that could lead to a downgrade

- » Deterioration of local economy impacting the pledged revenue and resulting declines in debt service coverage

## Key indicators

### Exhibit 1

Arlington (City of), TX					
Credit Background					
Pledged Revenues	Special taxes				
Legal Structure					
Additional Bonds Test	1.3 (sr) and 1.1 (sub); refunding only				
Open or Closed Lien	Closed lien				
Debt Service Reserve Fund Requirement	DSRF funded at MADS				
MADS Coverage					
2022 MADS Coverage (x)	2.0 (sr) and 1.5 (sub)				
Trend Analysis					
	2018	2019	2020	2021	2022
Revenues (\$000)	34,907	38,165	37,984	46,085	54,420
Annual Debt Service Coverage (x)	1.9x	1.4x	1.3x	1.5x	1.8x

Debt service coverage is for total debt service (senior and subordinate lien)

Sources: US Census Bureau, Arlington (City of) TX's financial statements and Moody's Investors Service

## Profile

The City of Arlington, TX is in the center of the [Dallas](#) (A1 stable)/[Fort Worth](#) (Aa3 stable) metroplex. The city encompasses 99.5 square miles and has a current population of approximately 397,000. The city provides services such as public safety (police and fire), streets, water treatment and distribution, wastewater collection and conveyance (treatment is done by the Trinity River Authority), parks and recreation, and public health services.

## Detailed credit considerations

### Tax base and nature of pledge: strong economy in Dallas/Fort Worth metro area; majority of pledge from broad sales taxes

The city is favorably located in the center of the Dallas-Fort Worth metropolitan area and the economy remains strong and will continue to grow. Manufacturing and distribution continue to be important to the city's economy, and the two industries are expanding. The city also benefits from its role as a hub of large regional entertainment centers which bolsters the tourism industry. Arlington is home to AT&T stadium, Six Flags and Hurricane Harbor, as well as two professional sports franchises — the Dallas Cowboys and the Texas Rangers. Additionally, the city benefits from the institutional presence of the University of Texas at Arlington, which has an undergraduate enrollment of approximately 35,000 or about 9% of the city's population.

Demographic and socioeconomic trends in the city will support continued economic stability over the near term. The city has a population of approximately 397,000, and has grown by about 1% annually since the last census. Median family income is near average at 93% of the national level as of the 2020 American Community Survey. The city's unemployment rate of 4.2% as of Feb. 2023 is below the state's 4.5% and slightly above the national rate of 3.9%.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

The senior and subordinate lien bonds are secured by city-wide pledged tax revenues which include a 0.5% sales tax, 2% hotel occupancy tax (HOT) and a 5% motor vehicle rental tax. Sales taxes consistently account for over 90% of the pledged revenue; sales taxes were 92% of pledged revenue in fiscal 2022, followed by HOT at 6.1% and the remainder from motor vehicle rental taxes. The taxable senior lien bonds (Series 2018B) are additionally secured by \$2 million in rental income from the Texas Rangers stadium.

#### **Debt service coverage and revenue metrics: strong revenue growth leads to solid coverage**

Debt service coverage for both the senior and subordinate lien bonds has improved over the past two years because of very strong growth in pledged revenue. In addition, the city has used excess pledged revenue to redeem callable subordinate lien debt; principal on the subordinate lien bonds from 2042-2048 has been redeemed and maximum annual debt service has declined to \$35.6 million (2037) from \$39.5 million (2048).

Despite the economic sensitivity of sales taxes generally, collections within the city have been resilient. Since 2013, sales tax collections have only declined once, by 0.7% in 2020 during the coronavirus pandemic. Unsurprisingly, the HOT and vehicle rental tax revenues exhibit larger swings with economic cycles. HOT taxes were down 31.5% in 2020; vehicle taxes have declined three times since 2013, including a 6.5% decline in 2020. However, because HOT and vehicle taxes make up only a small share (less than 10%) of the pledged revenues, total revenues have grown in every year other than 2020, which saw a modest 3.1% drop<sup>1</sup>.

Because of the revenue growth and because the city has used excess revenue to redeem callable bonds, maximum annual debt service (MADS) coverage for the subordinate lien bonds recently became sum sufficient. Coverage was below sum sufficient when the bonds were issued in 2018, but it has improved considerably since, which was a contributing factor to the upgrade. Total pledged revenue (including the stadium rental income) increased 21% and 18% in fiscal 2021 and 2022, respectively. As a result, subordinate MADS coverage improved and totaled 1.5x in fiscal 2022. Senior lien coverage has been improving as well because of the revenue growth and exceeded 2.0x in fiscal 2022.

#### **Liquidity**

Per the master indenture, excess pledged revenues will accumulate in the bond redemption fund and can only be used for payment of special tax debt service or early bond calls. The city annually uses excess cash to redeem callable bonds. The city projects retaining approximately \$40 million as of fiscal 2023 year-end (ending Sept. 30).

#### **Debt and legal covenants: strong legal framework including closed lien**

The senior and subordinate liens are closed. Total outstanding debt includes \$383.8 million of senior debt and \$93.6 million of subordinate debt.

#### **Legal security**

The senior lien bonds are payable from a first lien on certain city wide pledged revenues including a 0.5% sales tax, a 2% hotel occupancy tax, and a 5% motor vehicle rental tax. The senior lien taxable bonds (Series 2018B) are additionally payable from the rental income on the Texas Rangers stadium. The subordinate lien bonds have a second priority lien on the pledged revenues, after payment of the senior lien debt service and replenishing the senior lien debt service reserve fund, if needed. The senior lien bonds have a common debt service reserve fund (DSRF) maintained at the least of the IRS three-prong test, but no less than MADS. The subordinate lien bonds have a separate DSRF, also sized at MADS.

#### **Debt structure**

All of the special tax debt is fixed rate and final maturity is in 2048. The debt service schedule is ascending and maximum annual debt service occurs at final maturity.

#### **Debt-related derivatives**

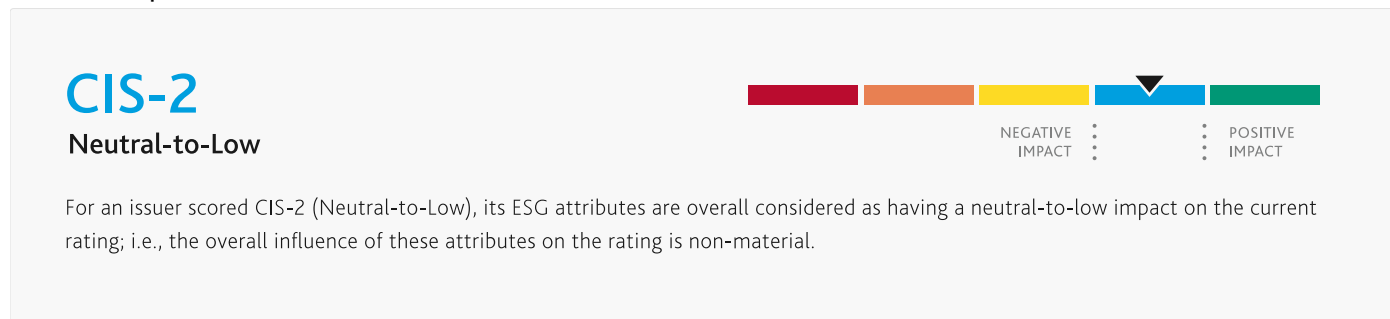
There are no derivative agreements associated with the special tax bonds.

## ESG considerations

### Arlington (City of) TX's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 2

#### ESG Credit Impact Score



Source: Moody's Investors Service

Arlington's ESG Credit Impact Score is neutral to low (**CIS-2**), reflecting low exposure to environmental and social risks, as well as a strong governance profile.

Exhibit 3

#### ESG Issuer Profile Scores



Source: Moody's Investors Service

#### Environmental

The city's overall E issuer profile score is neutral to low (**E-2**), reflecting relatively low exposure to environmental risks across all categories, including physical climate, carbon transition, water management, natural capital, and waste and pollution risks.

#### Social

We assess the S issuer profile score as neutral-to-low (**S-2**), reflecting relatively low exposure to social risks across all categories, including demographics, labor and income, education, housing, access to basic services, and health and safety. Population and the labor force have been growing, though the city's median family income as a percentage of the state and national medians has been modestly declining for the past few decades. Home prices remain affordable compared to the US median, residents have easy access to basic services and educational attainment is similar to most cities.

#### Governance

The city's G issuer profile score is positive (**G-1**). The city benefits from a strong institutional structure as well as strong budget management, as evidenced in outcomes that are favorable compared to expectations. The city adheres to established policies, produces detailed quarterly financial reports, and timely files audited financial statements and other required disclosures.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moody's.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

#### Endnotes

<sup>1</sup> These figures do not include the stadium rental income that began in 2020.

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